Company Law

2008/09

LLB

Queen Mary, University of London

Seminar Materials

Company Law

Seminar Outlines 2008/09

The structure of the course

The first seminars will be held in rotation starting from weeks 3 and 4 of the winter semester. Seminars are bi-weekly. Students must read the introductory chapters in any company law textbook by way of introduction to this topic before the first seminar. The course is structured so that these materials will be covered in lectures before students are required to consider them for seminars.

The following 10 seminars will form **the basis of the course**.

Seminar No.	Title	Date, depending on your group, week commencing
1	Introduction	6 October / 13 October
2	The *Saloman* principle	20 October / 27 October
3	Lifting the veil	10 November / 17 Nov.
4	Raising Capital - Issues of securities 1	24 November / 1 Dec.
5	Raising Capital - Issues of securities 2	8 December / 5 January
6	*Ultra vires* and constitutional documents	12 January / 19 January
7	Majority rule & minority protection	26 January / 2 February
8	Directors' duties	9 February / 23 February
9	Corporate governance 1	2 March / 9 March
10	Corporate governance 2	16 March / 23 March

NB: Weeks commencing 3 November and 16 February are *reading weeks* so there are no seminars in those weeks – hence the chronological gaps in the schedule above.

Question coverage: The questions in these seminar materials have been used for some time for this course (except for Seminars 4 and 5). You may not deal with all of them in the seminar, but you should prepare all of them in advance of the seminar. You will be advised in this by your seminar leader.

Seminar 1

Introduction

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1. In what circumstances would it be preferable to use which business model: sole trader; unincorporated association; partnership; private limited company; public limited company; or company limited by guarantee?

2. Barney is thinking of setting up his own business selling fruit and vegetables. He has some money of his own to put into the business but is likely to need more investment before he could afford to give up his job and start the business. Barney comes to you for advise as to the best legal form for his situation.
Advise him.

3. 'What is the point of company law?'

4. How did the company model develop historically in England, and latterly in the UK?

5. What was the general purpose and the policy underpinning the reforms in the Companies Act 2006?

6. Prepare a 300 word synopsis of the following case and be prepared to read it out in your tutorial: *Broderip v Salomon & Co. [1895] 2 Ch. 323 (C.A.).*

Seminar 2

The *Salomon* Principle

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1. "The principles outlined in *Salomon v Salomon & Co.* [1897] lie at the core of UK company law. Without them investment and risk taking would have been stifled and the world would be a less prosperous place."
Discuss.

2. Formulate the principle in MACAURA V NORTHERN ASSURANCE CO. [1925] A.C. 619. Why is MACAURA so often referred to as the most graphic example of the *Salomon* principle in action?

3. How can we understand the ways in which the principle in *Saloman* will be ignored by the courts?

4. "Limited liability allows businesses to evade responsibility for their actions." Discuss.

Seminar 3

Lifting the Veil

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1. Robert and Sally recently signed a franchise deal with Seed Ltd (a wholly owned subsidiary of Warble foods Plc) to set up a shop and sell Warble foods (a new kind of birdseed). They entered the franchise on the basis of a television advertisement in which the Managing director of Warble Foods Plc Dirk Riley claimed potentially vast earnings were there to be had from the birdseed market, a book Dirk had written called "Investing in Birdseed" and financial projections sent to them when they enquired about a potential franchise.

Things have not gone as well as expected and Robert and Sally have lost all their money. They have just discovered that Warble Plc has removed all the assets from Seed Ltd and placed it in liquidation.

Robert and Sally want to get their money back. Advise them.

2. Roger and his wife Kate are owed £5,000 by Jump Ltd. Jump Ltd has refused to pay the money owed and Roger and Kate have initiated a court action to recover the moneys owed to them. Bounce Ltd is the parent company of Jump Ltd and has recently been advised by its tax adviser that it could reduce its tax liability for the year 2005/2006 by removing all the assets from Jump Ltd and closing it down. Bounce Ltd has decided to follow the advice of its tax adviser.

Discuss the implications of this decision for Roger and Kate.

3. Considering the cases below be prepared to discuss the most modern interpretation of the Solomon principle.

Consider the following cases:-

ORD V BELHAVEN PUBS LTD [1998] BCC 607
WILLIAMS V NATURAL LIFE HEALTH FOODS LTD [1998] 1 W.L.R. 830 H.L.
EDWARD CONNELLY V RTZ CORPORATION PLC [1997] I.L.PR. 643
SCHALK WILLEM BURGER LUBBE V CAPE PLC [2000] 1 W.L.R. 1545

Seminar 4

Issues of Securities 1

"Public offers of securities"

This seminar considers:

- The Prospectus Directive 2003
- The FSA Prospectus Rules
- Part 6 of the Financial Services and Markets Act 2000, as amended
- The law on negligent misstatement

Questions:

1. What was the purpose of the Lamfalussy process at the EU level?

2. What is the purpose of the Prospectus Directive?

3. Wire plc is intending to issue shares to the public at large by admission of those shares to trading on the Main Market of the London Stock Exchange. Wire plc is in the business of manufacturing covert surveillance equipment for use by police and security services. Wire plc was validly incorporated in the UK in 2008 as a public company. This will be the first issue of its shares to the public. The board of directors is comprised of Daniels (Chief Executive Officer), Greggs (Chairman), Herc, and Carver, none of whom have any professional qualifications but all of whom have experience in managing small manufacturing companies. Herc and Carver have degrees in electrical engineering and are therefore the directors in charge of product development and design.

Advise Wire plc as to its regulatory responsibilities under the prospectus rules.

4. As before, Wire plc is intending to issue shares to the public. The process of preparing the prospectus has begun. Consider the following facts, and advise all the board and all the parties mentioned as to the preparation of the prospectus, including the suggested wording at the end.

(a) Wire plc has developed a new genre of surveillance devices known as "The Super Bugs" which have a common design feature which makes them particularly robust. As a result they can be concealed in small objects regularly left on the street (like tin cans or tennis balls) or around buildings under surveillance. The Super Bug has no patent yet, although a patent application has been lodged. Herc believes that the patent will not be awarded because it is very similar to a process used by another company; although Carver believes that there are enough differences between the two designs to constitute a separately patentable process.

(b) Greggs has commissioned a report from expert accountants, the Barksdale Group, which suggests that if the Super Bug design receive a patent and has successful field tests, then it should acquire about 50% of the market for "bugs", and

so should generate annual profits of £40 million. If the patent application or the field tests are unsuccessful, then it is suggested that Wire plc will not establish such a large market share and consequently that its annual profits are likely to be less than £5 million. The report mentions the name of Stringer, a senior partner of the Barksdale Group, although he did not approve the final version of the report despite being involved in much of its preparation.

(c) The board of directors of Wire plc is hopeful that Bunk will join the company as its chief research officer. Bunk is very well known in the law enforcement community in Europe and the USA, and so would grant Wire plc an enormous amount of goodwill and investor confidence, even though the company is new. Bunk is still haggling over his salary and so he has not yet signed a contract of employment with Wire plc; he has told the board of directors that he is considering alternative offers.

McNulty, the solicitor advising the company, prepared language for the prospectus which read:

> "The board of directors of Wire plc are confident that the pending patented process for the Super Bug will establish the company as one of the leading surveillance equipment companies in Europe. The level agreement reached with Mr Bunk to act as to the way in which he will become involved with the future of Wire's business plan demonstrates the standing of this company in the international surveillance equipment marketplace. Mr Stringer of the Barksdale Group has therefore been able to predict profits of at least £40 million per annum."

(McNulty has since gone on record as saying: "What did I do?".)[1]

5. The facts are as before. However, Wire plc issued shares to the public using the language which McNulty drafted for the prospectus in the preceding question on 1 September 2008. Bunk in fact took work elsewhere; and the patent application was refused, but is currently under appeal. This information was made public on 1 October 2008.

The strategy for the issue of shares in September 2008 was, however, changed: the investment bank leading the issue process advised the placement of shares with a small number of expert investors, including Marlo, who all relied on the terms of the prospectus. Marlo sold his shares on 15 September 2008 to Bubbles, at a total loss to Marlo of £10,000. The reason for the loss was the publication of the news that a competitor of Wire plc was awarded a patent for its equivalent of the Super Bug range of products, and therefore shares in Wire plc fell in value. Bubbles had relied on the statements made in the prospectus. By 2 October 2008, the market value of shares in Wire plc had fallen by 50% and so Bubbles suffered a total loss of £50,000.

Advise Marlo and Bubbles.

[1] If you have never watched *The Wire*, this comment will not make much sense but it does not really matter to the problem.

Seminar 5

Issues of Securities 2

"Transparency and Inside Information"

This seminar considers:

- Insider dealing: Part V of the Criminal Justice Act 1993
- Market manipulation: s.397 FSMA 2000, etc.
- The Market Abuse Directive
- The FSA Market Abuse Rulebook
- The Consolidated Admission and Reporting Directive 2001
- The Transparency Obligations Directive 2004
- The FSA Listing Rules
- The FSA Disclosure and Transparency Rules
- Part 6 of the Financial Services and Markets Act 2000, as amended
- Part 43 of the Companies Act 2006

Questions

1. Considering the range of regulation of prospectuses, transparency obligations and insider dealing both across the EU and within the UK specifically, and also the liability under English case law for negligent misstatement, what is the approach (or, what are the approaches) of securities law to the provision of information generally?

2. Why do we criminalise insider dealing? What are its objectives? Is the regulation of market abuse by the FSA a more promising avenue?

3. *The facts of this problem are based on the facts of Questions 3, 4 and 5 of the preceding seminar's materials. They relate to dealings in the shares of Wire plc. Those shares were issued to the public on 1 September 2008, as considered in Question 5. Consider the criminal liability of the persons involved in the following scenarios in relation to events after 2 October 2008.*

(a) Carcetti, Chief Executive of the Italian company "Baltimori", an electronics giant in Europe and competitor of Wire plc, met with Daniels, Chief Executive of Wire plc, in Milan on 1 November 2008 to discuss the possibility of a takeover of Wire by Baltimori. This meeting was held in secret at the house of a mutual friend of both parties. Carcetti bought himself 100,000 shares in Wire plc on 2 November after the meeting seemed promising.

(b) What would be the effect on your advice if you knew the following? First, that shares in Wire plc stood at 100 pence at the opening of business on 2 November 2008. Secondly, that on 3 November Carcetti had lunch with the Milan business correspondent of a London newspaper that same day when he ostentatiously placed a copy of Wire plc's accounts on the restaurant table when the journalist asked "do you see any prospects for the consolidation of businesses in the electronics sector in Europe?"; such that the correspondent published a story the next day under the

headline “Hints of Takeovers on the Wire”, which suggested that Wire plc was likely to be taken over. Thirdly, that the value of shares in Wire plc rose to 150 pence by 5pm on 3 November 2008. Fourthly, that Carcetti sold his shares on 4 November for 155 pence.

(c) Daniels encouraged his brother-in-law, Joe, to buy shares in Wire plc over lunch on 3 November – by which time the price had risen only to 130 pence – because Joe was in danger of going bankrupt. Joe did not buy the shares because he thought Daniels was an idiot.

(d) Greggs learned of the success of Daniels’ meeting with Carcetti by telephone on 2 November and so bought a “call option” from Monster Bank in the name of a company which she controlled, which entitled her company to buy 200,000 shares in Wire plc from Monster Bank for 140 pence at any time she should choose. Greggs exercised her right on 4 November and made £30,000 profit.

(e) Herc entered into a put option with Monster Bank on 5 November 2008 whereby he could sell his holding of 200,000 shares in Wire plc to Monster Bank for 140 pence; at the same time he also entered into a call option to buy 200,000 shares in Wire plc from Monster Bank for 120 pence. On 6 November 2008 Herc made a statement during a filmed interview for a financial newspaper’s web-site that he was “concerned that Super Bug technology would not be profitable”. The share price of Wire plc fell to 110 pence as a result. Herc exercised his put option selling his shares for 140 pence to Monster Bank on 6 November. On the evening of 6 November 2008 he issued a press release to say he had misspoken and that he had meant to say he was “concerned that Super Bug technology would not be profitable *for the next six months, but that it would be very profitable in 2009*”. The share price rose back to 150 pence. Herc exercised his call option and acquired 200,000 shares in Wire plc under the call option from Monster Bank for 120 pence.

4. Consider the facts of Wire plc’s issue of shares in Question 3 of the preceding seminar’s materials. What advice would you give to the board of directors of Wire plc as to their regulatory obligations and the company’s obligations under the listing rules.

5. Under Question 5 of the preceding seminar materials, what further action should be taken by the company as soon as the information is known under the listing rules?

6. Consider the facts of Wire plc’s issue of shares in Question 3 of the preceding seminar’s materials. What action should be taken under the transparency obligations rules if Daniels were to acquire 4% of the shares in Wire plc on 3 October 2008 by means of a trust in which his wife is the sole beneficiary? What action should be taken if on 15 October 2008 Daniels increased his personal holding of shares in Wire plc from 1% to 6%?

Seminar 6

The *Ultra Vires* Doctrine and the Company's Constitutional Documents

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1. What is the significance of Lord Wilberforce's speech in HOWARD SMITH LTD v AMPOL PETROLEUM LTD. [1974] A.C. 821 for the operation of the corporation.

2. Roy, John and Sarah are the directors of Abbot Ltd, a company that manufactures horseshoes. They also each hold one-third of the shares in the company. The articles of association are Table A amended by the following clause:

> "All decisions of the board are by majority vote except for votes on transactions with a value greater than £50,000. In such case a decision is only valid if all the directors consent to the transaction."

Roy, John, Sarah and the company are also the only parties to a shareholders' agreement in which all the parties agree not to increase the share capital of the company without the agreement of all the parties to the shareholders' agreement.

Roy has recently returned from holiday and found that during his absence there had been a Board meeting which approved the purchase of a large tract of land for development purposes worth £100,000. The Board also proposes funding the purchase by increasing the share capital of the company. Roy is very unhappy about these developments and wishes to stop them.

Advise Roy.

3. Delia is a 10% shareholder in Veggies Ltd. The main object of Veggies is the manufacture and sale of vegetarian products. The company's articles follow Table A, but state that any transaction exceeding £50,000 must be approved by the shareholders in general meeting.

Erica is acting as the managing director of the company, although in fact her appointment was made at an inquorate board meeting. Erica is concerned about falling sales of the company's vegetarian products, and decides to start selling burgers made of beef. She agrees with Footinmouth Ltd. to purchase a quantity of beef from Footinmouth for £60,000. When Delia learns of the foregoing, she is outraged.

Advise Delia:

(a) if she can force Veggies to avoid the contract to purchase the beef from Footinmouth;

(b) if she can prevent Veggies from entering into any other such contracts in the future:

(c) if she can take any action against Erica, or any of the other directors of Veggies.

Seminar 7

Minority Protection

Questions

1. What is the rationale behind the Rule in *Foss v Harbottle*?

2. 'The exceptions to the Rule in *Foss v Harbottle* serve no useful purpose in protecting minority shareholders.'

Discuss

3. How are minorities protected under the Companies Act 2006?

4. Rodney and Dell run a successful wholesaling partnership, specialising in high quality designer clothing. They decide to expand the business but need additional capital to finance their plans. Knowing that their mutual friend, Rachel, has just inherited a substantial sum of money they persuade her to invest £50,000 in a joint venture with them. They incorporate a new company, Trendywear Ltd., with the issued shares taken in three equal parts by Rodney, Dell and Rachel respectively. The understanding between them is that the new company will take over and expand the wholesaling business; that Rodney and Dell will work full time in the business; that all three will be members of the board of directors and that the company's profits will be distributed in three equal shares by way of directors' remuneration.

Trendywear Ltd. is run in accordance with this understanding for three years. The company is profitable, but not on the scale anticipated by Rodney and Dell. They decide, without consulting Rachel, that the company should acquire a number of retail outlets in shopping malls from which to operate shops. The scheme involved a large capital expenditure. Rachel is informed that for an indefinite period the company, because of the debt-servicing burden that the expansion scheme involves, will only be able to pay a fixed salary to Rodney and Dell in return for their full time services and that Rachel must forego profit in favour of capital growth of her investment. They also vote Rachel off the board. Rachel asks to be bought out. Rodney and Dell refuse, informing her that all company resources are needed for the expansion.

Advise Rachel

Seminar 8

Directors' Duties

Questions

1. Harry is the managing director of Acme plc, a large pharmaceutical company. In recent years the company has enjoyed record levels of profitability. It is generally recognised that the company's success is due to Harry's acumen. In the past twelve months the following events have occurred :

a) Harry is paid £1 million consultation fee for successfully guiding Acme plc through a take-over of Xon Ltd., a competing business. This payment was agreed by a special committee of the board constituted to advise the main board on mergers and acquisitions. The main board has never approved the payment.

b) Harry forms a private company, Drugco Ltd., which processes raw materials for use in pharmaceuticals. Harry places large orders with Drugco Ltd. without informing Acme Plc of his interest in Drugco Ltd.

c) Harry is approached by Bluesquare Inc., a large U.S. pharmaceutical company. Bluesquare intends to establish a drug manufacturing plant in England, and wishes to set up a joint venture with Acme plc. Harry convinces Bluesquare Inc that Drugco Ltd would be a better partner for the venture.

Acme plc has recently been taken over by Xtacy plc. The details of the events outlined above have now come to the notice of the board of Xtacy. They wish to pursue any claims they may have against Harry.

Advise the board of Xtacy plc.

2. What are the duties imposed on directors by the Companies Act 2006? What the purpose behind their introduction?

3. What do you understand the director's duty "to act in the interest of the company and not for any other purpose" to mean?

4. "The law has set the standard for the directors duty of skill and care so low that were a company to appoint a monkey as managing director he would be unlikely, no matter what decisions he made, to breach the standard of skill and care required of him."
Discuss.

Seminar 9

Corporate Governance 1

Questions

1. Find, read and be prepared to discuss the following in tutorial:-

- Dodd, 'For Whom Are Corporate Managers Trustees?", [1932] *Harvard Law Review* 1145.
- Berle, "For Whom Are Corporate Managers Trustees: A Note" [1932] *Harvard Law Review* 1365

2. "The corporate governance debate is really a debate about accountability, unfortunately no-one can agree what they mean by accountable. The business community thinks its something to do with accounts and financial reporting, the politicians think its something to do with a 'stakeholder' economy and the academics think it's either about morality or efficiency. All in all it seems to mean all things to all people. No wonder no progress has been made since the 1930s"

Discuss.

3. Does economic theory add anything to a traditional analysis of the function of company law?

Seminar 10

Corporate Governance 2

Questions

Consider:-

- The Higgs Report
- The Cadbury Report
- The Turnbull Report
- The "Combined Code on Corporate Governance".

You will also have been given extracts from Alastair Hudson, *Securities Law*, Chapter 6.

1. Consider the current directors' duties reforms and the new operating and financial review. Do you think they provide an adequate response to the claims of stakeholders to inclusion in the decision making process of the company?

2. To what extent have the UK corporate governance committees been a success?

3. In what way has the collapse of US company Enron had an effect in the UK? (Do watch *The Smartest Guys in the Room* on DVD to prepare for this, and "google" Enron for commentary. See also the collapse of WorldCom.)

End